Supreme Court, U.S.
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1997

DALE WOOTTON, TRUSTEE,
PETITIONER
V.
WOODY F. LEMONS,
RESPONDENT

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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5888

QUESTION PRESENTED

I.

WHETHER OR NOT THE COURT SHOULD ADOPT THE "FUNCTIONAL" APPROACH TO DEFINING EXECUTORY CONTRACTS IN BANKRUPTCY CASES, AS OPPOSED TO THE "COUNTRYMAN" APPROACH, WHICH APPEARS TO HAVE BEEN PREVIOUSLY ADOPTED BY THE COURT.

THE PARTIES

Woody F. Lemons, Original Defendant and Respondent

John Copeland, Wilson, White & Copeland, L.L.P., Attorney for Woody F. Lemons

Dale Wootton, Bankruptcy Trustee for Don R. Dixon, Chapter 7 Debtor

Bradson Partners, Ltd, Assignee of Woody F. Lemons

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1997

DALE WOOTTON, TRUSTEE,
PETITIONER
V.
WOODY F. LEMONS,
RESPONDENT

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Dale Wootton, Trustee, petitions for a *writ of certiorari* to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The judgment of the Court of Appeals was issued on October 10, 1996 affirming the judgment of the District Court. (Appendix C). The Order of the District Court was issued on September 29, 1996, which affirmed the judgment of the

Bankruptcy Court. (Appendix B) The Bankruptcy Court entered its Order on November 14, 1994. (Appendix A).

JURISDICTIONAL STATEMENT

The jurisdiction of this Court is invoked under 28 U.S.C. §1331 and 28 U.S.C. §1344. The date of the judgment sought to be reviewed is October 10, 1996. Jurisdiction in the Northern District of Texas Bankruptcy Court was based on 28 U.S.C. §1334. Appellate jurisdiction to the Fifth Circuit Court of Appeals was based on 28 U.S.C. §1291.

APPLICABLE FEDERAL QUESTION

Whether a Trustee in bankruptcy can use the "Functional Approach" in determining the validity of an executory contract within the meaning of 11 U.S.C. §365.

STATEMENT

This is a bankruptcy case where the critical issue is the determination of the nature of an oral agreement between the Debtor and a business associate, and whether or not it is an executory contract, and if so, whether the Trustee can use the "functional approach" on the executory contract.

This is a claim made by Woody Lemons in the bankruptcy case of his business associate, Don R. Dixon. Woody Lemons was President of Vernon Savings and Loan Association. Dixon controlled the association through Dondi Financial Corporation, which held a controlling interest in the stock of Vernon. Lemons claimed a portion of the sales proceeds of stock in an automobile dealership sold by the trustee. Lemons alleged that he had an oral agreement with Dixon to convey the stock to him. The trustee takes the

position that Lemons had an executory contract which was rejected as a matter of law, and alternatively that the oral contract was indefinite and unenforceable.

The Trustee sold the stock for $1,600,000.00 and now part of that money is being reclaimed from the estate.

This case arose out of the bankruptcy case of Don Dixon, one of the principal figures in the savings and loan scandal of the 1980's.

After Dixon took over Vernon Savings, he and Lemons began negotiating to buy several automobile dealerships in California. Dixon apparently wanted Lemons to be involved in the effort to secure financing for the transactions. According to Lemons, he was instrumental in arranging financing with Commodore Savings and Sandia Savings in order to complete the purchase. Although Lemons did not have any of the

closing documents on the transaction, he testified that according to his best recollection, the purchase price was somewhat in excess of $9,000,000.

The deal was structured so that no one would have to put any cash equity money into the project, except interest payments on the loans, and possibly some points that were charged for the loans at closing. Sandia Savings loaned $1,000,000 for the purchase of the dealerships and Commodore loaned the balance of approximately $8,000,000. Lemons guaranteed the two notes at Commodore Savings in the approximate amount of $4,000,000 each. One of the loans was made to Dondi Motor Car Properties, a limited partnership that apparently was to own the real estate, and the other was made to Symbolic Motor Cars of Newport Beach, a corporation, that was purchasing the assets.

Lemons testified that when Dixon first asked him to join in this enterprise, Dixon would own 60% of the venture and Lemons would own 40%, and all of the stock would be held in Dixon's name. Later, Lemons share was reduced to 27.5%. Neither Dixon nor Lemons could recall at the time of trial the reason for all of the stock being held in Dixon's name. However, Lemons testified that his memory was that one or more of the franchises, possibly BMW, required that the stock be held in this manner.

Lemons testified that prior to the time the purchase was closed he did not receive any document or letter agreement or any other thing in writing that discussed or agreed as to what his participation in the venture would be.

Lemons testified that he executed a settlement agreement between the FDIC and

himself and his family. In his affidavit attached to the settlement agreement Lemons stated "I have no ownership interest in any partnership, firm or corporation, except . . . " and the answer listed a dozen or so interests in various corporations, but did not list any interest in Sterling Motors, Ltd. At trial, Lemons testified that he did not list any interest in Sterling Motors, Ltd. because he believed that it was listed as a "claim" against the Bankruptcy. By his own testimony, Lemons concedes that he did not own any stock in the corporation but only had a claim in the bankruptcy. This fact is significant to the Trustee's argument in this case.

Lemons also testified that he could not say whether or not he knew about the sale of the Sterling Motor's stock by the Bankruptcy Trustee at the time he signed the settlement agreement with the FDIC.

In Dixon's bankruptcy schedules titled "Property Held for Another Person", he refers to his arrangement with Lemons regarding Sterling Motors, Ltd. The schedules included the following statement: "Stock in these three companies held by Don R. Dixon was to have been contributed to a partnership comprised of Don R. Dixon, Woody F. Lemons, and possibly others. (Depending on whether such other persons would guarantee certain debt and contribute certain capital). Lemons was to receive 27.5 percent of such partnerships' interest, however, Dixon and Lemons subsequently entered into a verbal agreement that Lemons' interest in such partnership would revert to Dixon once Lemons was relieved of all liabilities attendant to the Sterling/Symbolic ownership." The most significant fact in this case, that has been consistently

overlooked by the lower courts, is the undisputed statement of Dixon that Lemons'interest would revert to Dixon once Lemons was relieved of all liabilities attendant to the Sterling/Symbolic ownership.

According to this statement in Dixon's bankruptcy schedules, Lemons was apparently only to be an accommodation maker on the notes to purchase the properties. Dixon was to get all the stock back at some point in time. In his bankruptcy schedules, Dixon listed 650 shares of common stock of Sterling Motors, Ltd., Newport Beach, California, with an estimated value of $2,500,000. The schedules indicated that this stock was:

> "Subject to option to sell 80 shares to Peter Young for $80,000 and subject to option to acquire 150 shares from John Belanger at $1.00. Also subject to agreement to transfer to a

partnership comprised of Don R. Dixon, Woody F. Lemons and possibly others."

As further evidence that the agreement had not been consummated, Dixon listed in his bankruptcy schedules of executory contracts, the "oral agreement to convey to a partnership comprised of Don R. Dixon, Woody F. Lemons, and others, the Debtors shares in the Sterling Companies, subject to certain terms and conditions, included but not limited to the requirement that Don R. Dixon's ownership interest not be diluted beyond 50% and that Woody F. Lemons receive a 27.5% interest."

The bankruptcy court reconciled the obvious conflict in the testimony of Dixon and Lemons by giving Lemons a judgment for 27.5% of 57% of the total of 1,000 shares of stock, which equaled 156.57 shares.

REASONS FOR GRANTING WRIT

The reason for granting this writ is because it is now time for the courts to uniformly adopt the functional approach to analysis of executory contracts, as opposed to the formerly used "Countryman" definition approach. This is an important question in the administration of bankruptcy cases for trustees all over the country. In addition, there is a conflict in the Circuit Court positions on this matter. In the Second Circuit in the case of Cohen v. Drexel Burnham Lambert Group, Inc. (In Re Drexel Burnham Lambert Group, Inc. 138 B.R. 687 (Bankr. S.D.N.Y. 1992), the court adopted the functional approach. The Fifth Circuit, in a prior opinion arising out of this same bankruptcy case stated that "although we do not doubt, that in certain cases a functional or substance over form definition might be appropriate, we believe that this case is

hardly the one in which to adopt such a definition of executory." In this case, the Court did not even address the issue presented as to whether or not the functional approach should be adopted. The trustee maintains that the Fifth Circuit should adopt the functional approach. Uniformity in the analysis of executory contracts is critical to the proper administration of bankruptcy estates for trustees and debtors and debtors-in-possession.

The issue presented is not unlike the issue presented in the *D'Oench Dume Doctrine*. The Federal banking authorities do not have to recognize "side deals" and oral agreements made by bank officers that are not reflected in the bank's files and contracts. Trustees in bankruptcy should not have to sift through alleged oral agreements to determine the true nature of

should have the ability to reject such oral contracts that are not beneficial to the estate, by applying the "functional approach."

Appellant is the Chapter 7 trustee in a bankruptcy case. The real issue in this case is whether or not Woody Lemons, the Appellee, owns the property in question, and therefore, in effect, gets paid with the highest priority, which includes administrative claims, or whether he merely has a contract which, if enforceable, allows him an unsecured claim, along with all other contract claimants who have had their contracts breached.

The Trustee contends that Woody Lemons, the Claimant, at the most, had an oral contract with Don Dixon, the Debtor, to obtain a stock interest in the company Dixon was acquiring. If there was an enforceable oral contract in existence at

the time the Dixon bankruptcy was filed, the Trustee had the right, and, more importantly, the duty to reject (or breach) the contract as an executory contract and allow a claim to the creditor for damages for that breach. That claim would then be paid pro-rata with all other unsecured creditors.

The Trustee contends that the Supreme Court should adopt the "functional" approach in determining whether or not this contract is executory and could be rejected. The Fifth Circuit said in a previous opinion, arising out of this same Bankruptcy case, that " . . . in certain cases a functional or substance over form' definition might be appropriate . . .", although the court declined to adopt it in that case. The Trustee argues that this case is a much more appropriate case to adopt the "functional" approach.

The testimony of Dixon and his bankruptcy schedules showed that there was an oral agreement that the stock held by Dixon was to be contributed to a partnership comprised of Dixon, Lemons and "possibly others". That had not occurred at the time the bankruptcy was filed. Then there was a subsequent oral agreement that Lemons interest would revert back to Dixon once Lemons was relieved of all liabilities regarding the stock ownership. That had also not occurred at the time the bankruptcy was filed.

The undisputed agreement that Lemons interest would revert back to Dixon once Lemons was relieved of liabilities is significant evidence of the executory nature of this oral contract, even under the "Countryman" definition, which both lower courts relied upon. Under the "Countryman" definition, there was an

unperformed obligation of Lemons to reconvey the stock to Dixon upon that occurrence. There was also the unperformed obligation of Dixon, at the time the bankruptcy was filed, to contribute the stock to a partnership composed of Dixon, Lemons and "possibly others".

Lemons argues that he had a substantial net worth and that his credit was necessary to obtain the loans to buy the stock, and that he, in fact, signed the notes for Dixon to buy the stock. However, if that was the agreement and Dixon was required to convey the stock to a "partnership" including Lemons, and possibly others, at a later date; and then Lemons was required to reconvey the stock to Dixon when he was relieved of those same liabilities, then Lemons was nothing more than an "accommodation maker" for Dixon. *See* §3.415, Texas Business and Commerce

Code and Felker v. Thomas (Tex. Civ. App. 1935), 83 S.W.2d 1055.

The stipulated testimony of Dixon in this case shows that if this oral agreement was fully carried out by both parties, then Lemons would ultimately end up with nothing. All of his stock would have been reconveyed to Dixon when he relieved Lemons of all "liabilities attendant to the Sterling/Symbolic ownership." The significance of this fact was not apparent to the lower courts in their analysis of the executory nature of this contract. The "effect" of the Trustee's rejection would then bring both parties to their mutually intended conclusion of this entire transaction.

The final reality of this case may be that it really does fit the "Countryman" definition of an executory contract, but that the rationale and logic of the "functional" approach gives even more

credibility to the Trustee's position that this contract should be rejected.

This is the second case in this bankruptcy estate in which the Trustee has sought to reject an executory contract. The Fifth Circuit opinion in *Young* was unpublished. (It is provided to the Court as Appendix D).

The most significant difference in the *Young* case and this case is that here there was an agreement that Lemons would reconvey all of the stock to Dixon when Lemons was "relieved of all liabilities attendant to the Sterling/Symbolic ownership.

Executory Contract Analysis:

As the Fifth Circuit pointed out in the Young case, the Trustee argued that this circuit should adopt a "functional" definition of the term "executory" as used in Section 365(a), as opposed to the traditional "Countryman" definition. The

Trustee conceded that a "functional" definition has only been adopted by a minority of courts. See Sharon Steel Corp. v. National Fuel & Gas Distr. Corp., 872 F. 2d 36, 39 (3rd Cir. 1989). The Fifth Circuit noted that they had never expressly adopted either definition, although they did observe that the United States Supreme Court appears to have adopted a definition akin to Countryman's. See National Relations Board v. Bildisco & Bildisco, 465 U.S. 513, 522 n.6 (1984).

The cases of Cohen v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc. 138 B.R. 687 (Bankr. S.D.N.Y. 1992), and In re Walnut Associates, 145 B.R. 489 (Bankr. E.D. Pa. 1992), followed the lead of two learned commentators, Michael Andrew and Jay Westbrook, in advocating the "functional"

approach and concluding that the effect of rejection should be quite limited.

The effect of rejection is dealt with by Section 365(g). Subject to some exceptions, that section states:

> [T]he rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease--(1) if such contract or lease has not been assumed . . ., immediately before the date of the filing of the petition; or
>
> (2) if such contract or lease has been assumed . . . at the time of such rejection.

The apparent import and intent of Section 365(g), together with Section 502(g), is to give the nondebtor party a prepetition unsecured claim for breach upon rejection if the contract was never assumed in the bankruptcy case. If the contract was assumed and then rejected, the damages claim becomes an administrative priority. In short, the relevance of assumption is that the bankruptcy estate chooses to

become a party to the contract, and accordingly becomes administratively obligated thereunder. Rejection appears to be nothing more than the flip side of assumption; that is, the estate chooses not to become a party to the contract. The breach provision gives the nondebtor party a claim in the bankruptcy case, lest they be left remediless.

In this case, the Trustee chooses not to be a party to the contract, and agrees that lemons should have an unsecured claim in the bankruptcy estate, but not an administrative claim.

Whether the estate's nonliability operates because of an exclusionary analysis, whereby the property never comes into the estate unless affirmatively assumed (the Andrew view), or because of an abandonment theory, whereby the contract comes in under Section 541 but then is

abandoned (the Westbrook view), the result in the typical case is the same.

Still, some confusion has developed regarding the effect of rejection. One theory is that rejection somehow obliterates or eliminates the contract itself; i.e., after rejection, the contract (and its many assorted provisions, remedies and the like) no longer exists. Under this view, rejection eradicates contract liabilities and deprives the nondebtor party of the ability to enforce the contract against the debtor, and may even deprive the nondebtor party of underlying property rights connected with the contract--what Andrew has called "avoiding-power rejection". This approach was used in the Fourth Circuit case of Lubrizol Enterprises, Inc. v. Richmond Metal Finishers,Inc., 756 F. 2d 1043 (4th Cir. 1985), cert denied, 475 U.S. 1057 (1986),

in which a nondebtor licensee of certain technology was deprived of rights to the technology by the debtor-licensor's "rejection" of the license agreement. Although Congress undertook to remedy that specific error by enacting Section 365(n), the underlying conceptual error that led to the decision remained uncorrected.

After Lubrizol, Michael T. Andrew published his influential article, Executory Contracts in Bankruptcy: Understanding "Rejection", 59 U. Colo. L. Rev. 845 (1988). In that article he exploded the myth of rejection-as-obliteration, and explained thoughtfully the rejection-as nonassumption (and nothing more) position. Following this article was Jay L. Westbrook's outstanding contribution, A Functional Analysis of Executory Contracts, 74 Minn. L. Rev. 227 (1989). Andrew responded with Executory

Contracts Revisited: A Reply to Professor Westbrook, 62 U. Colo. L. Re. 1 (1991).

The courts in Drexel and Walnut Associates adopted the theories propounded by Andrew and Westbrook. Each court rejected the "obliteration" concept, and determined that rejection gave a remedy for breach, but no more.

In Drexel the court undertook a lengthy discussion and analysis of the Andrew and Westbrook articles, along with the articles written in the early 1970's in the Minnesota Law Review by Professor Countryman. Following Westbrook's lead, the court first stated "that the plain language of §365 . . . compels the conclusion that a rejected contract is actually breached, and the breach is deemed to have occurred immediately preceding the bankruptcy filing".

Then the court adopted several principles from Andrew and Westbrook

relevant to the trustee's assume-or-reject option. Significantly, the court determined that rejection gives the nondebtor party a remedy for breach, but does not eliminate the contract itself. Accordingly, it is not necessary to impose a threshold test of "executoriness" as a prerequisite to assumption or rejection. Furthermore, rejection does not serve as a disguised avoiding power; rights of nondebtors stemming from the contracts are not eradicated by rejection. The court then synthesized a four-step analysis to govern the trustee's decision whether to assume or reject.

1. The trustee must first determine whether the contract gives to the nondebtor party an enforceable interest in property of the debtor that is passed to the estate, such as a security interest, or as here, Cohen's property interest in the escrowed bonds;

2. The trustee must next consider whether any such interest of the nondebtor is avoidable under the

Code's avoiding powers (such as sections 547 and 548);

3. If there is no such interest (i.e., no secured claim or the like), or if such an interest is avoidable, the trustee must determine whether the state will benefit more from the breach and payment of the resulting claim in bankruptcy dollars, or by performance; and

4. If the nondebtor has an unavoidable interest, the trustee must determine whether under this circumstance the estate will benefit most from breach or performance.

Id. at 709 (citing Westbrook, A Functional Analysis of Executory Contracts, 74 Minn.L.Rev. at 336).

In upholding Cohen's right to the bonds held in escrow in *Drexel*, it is important to note that he had done several things that Lemons had not done. He had:

a. paid for his stock,
b. obtained delivery pre-petition,
c. received interest,
d. paid taxes on the interest.

There was also no agreement that Cohen would reconvey the bonds upon the

occurrence of some future event, unlike in the Lemons case.

In Walnut Associates, the Court agreed with the legal conclusions of the Drexel Court that rejection of an executory contract constitutes merely a refusal of a debtor's estate to assume a contract and accord administrative status to the claims of the non-debtor party to the contract and that rejection of any executory contract does not invalidate, rejudicate, repeal, or avoid an executory contract.

This is not to say that rejection has no effect, it does mean that the non-debtor party to the contract subject to rejection is limited in its claims for breach to the treatment accorded to a debtor's general unsecured creditors.

The Court joined Westbrook in emphasizing that, since the consequences of rejection should not be very momentous, the

definition of an executory contract should be very broad.

What did Lemons really have?

If he had an unwritten contractual right to receive the stock, and that contract was only partially fulfilled in the time the bankruptcy was filed, then the trustee should be allowed to reject or breach the contract, because it clearly had no benefit to this estate, because "the purpose of the provision allowing a Trustee to assume or reject any executory contract or unexpired lease is to allow a Trustee to pick and choose among the debtors' agreements and assume those that benefit the estate . . ." In re G-N Partners, 48 B.R. 462, 465 (Bankr. Minn. 1985). See also: In Re Aslan 909 F. 2d 367 (9th Cir. 1990).

In the case of In Re Waldron, 36 B.R. 633 (Bankr. S.D. Fla. 1984), the court

follows the "Functional Approach" but calls it "Result Orientation" instead. In Waldron, the Court concluded that an option contract to purchase real property was an executory contract within the meaning of §365 and therefore subject to rejection, citing In re Jackson Brewing Co., 567 F. 2d 618 (5th Cir. 1978).

In the case of In re G-N Partners, 48 B. R. 462, 465 (Bankr. D. Minn. 1985), the court reiterated the purpose of the provision allowing a trustee to assume or reject any executory contract or unexpired lease which is to allow a trustee to pick and choose among the debtor's agreements and assume those which benefit the estate and reject those which do not.

The Court further stated that:

"To say that much has been written and little concluded about what constitutes an executory contract is an understatement. Hume noted that 'Beauty in things exists in

the mind which contemplates them'. I think that the same is true of executory contracts." *supra*, p. 465.

CONCLUSION

For the foregoing reasons, this Court should grant this writ and the judgment of the Fifth Circuit should be reversed.

Respectfully submitted,

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APPENDIX A

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In Re:	§	
	§	**Case No.387-33941-**
DON R. DIXON and	§	**RCM-7**
DANA DENE DIXON,	§	**Chapter 7**
	§	
Debtors.	§	

ORDER

On Friday, October 21, 1994 the *Motion to Turn over Proceeds from Sale of Stock* held by WOODY F. LEMONS ("Lemons") was heard by this Court. The Court has made Findings of Fact and Conclusions of Law. In accordance therewith,

THE COURT ORDERS that Woody F. Lemons recover from the Bankruptcy Estate of Don R. Dixon and Dana Dene Dixon the sum of $385,846.39, together with pre-judgment interest thereon at the rate of 10% per annum from October 1, 1993 to the date of

signing of this Order in the amount of $43,183.36, for a total recovery of $429,029.75, together with costs, together with interest at 6.06% from this date until paid.

Signed this 14th day of November, 1994.

ROBERT C. McGUIRE,
U. S. BANKRUPTCY JUDGE

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

DALE WOOTTON, TRUSTEE	§	
	§	
Appellant,	§	Civil No.
	§	3:95-CV-0059-H
v.	§	BK 387-3391-
	§	RCM-11
WOODY F. LEMONS	§	
	§	
Appellee.	§	

ORDER

On September 29, 1995, the Court heard argument on the appeal from a judgment of the Bankruptcy Court.

After considering the briefs filed by the parties, the relevant authorities, and the argument and representations of counsel, the Court was of the opinion, for the reasons stated in open court, that the judgment of the Bankruptcy Court should be, and it was, **AFFIRMED.**

SO ORDERED.

DATED: September 29, 1995.

_____

BAREFOOT SANDERS, JUDGE
UNITED STATES DISTRICT
COURT
NORTHERN DISTRICT OF TEXAS

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 95-10939

IN THE MATTER OF:
DON RAY AND
DANA DENE DIXON

Debtors,

DALE WOOTTON, Trustee,

Appellant,

versus

WOODY F. LEMONS,

Appellee.

Appeal from United States District Court
for the Northern District of Texas
(3:95-CV-59-H)

Before PENAVIDES, STEWART, and DENNIS
Circuit Judges.

PER CURIAM:* Filed October 10, 1996

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* Pursuant to Local Rule 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in Local Rule 47.5.4.

Wootton appeals the district court's affirmance of the bankruptcy court's finding that, pursuant to the parties' oral agreement, Woody F. Lemons owned 27 1/2% of 57% of the stock in Sterling Motors, Ltd. at the time Dale Dixon filed for bankruptcy, and that Lemons was entitled to the selling price of $385,846.39 plus prejudgment interest at a rate of 10% per annum from October 1, 1993 to the date of entry of judgment on November 11, 1994. Wootton argues that the oral agreement between Lemons and Dixon was an executory contract which should be rejected as a matter of law.

After thoroughly reviewing the record, we agree with the district court that the parties agreed that Lemons owned 27 1/2% of the stock upon acquiring the financing for the dealerships. A finding that Lemons obtained an ownership interest in the 27 1/2% shares of stock precludes a

finding that Lemons and Dixon's oral agreement was an executory contract because an executory contract by definition requires future performance by the parties. See In re Jackson Brewing Co., 567 F.2d 618, 623 (5th Cir. 1978). Lemons' performance was completed when he negotiated, obtained, and personally guaranteed the $9 million needed to finance the dealerships. There was no performance remaining for Lemons under the oral agreement. Therefore, we AFFIRM the district court's judgment affirming the bankruptcy court's award to Lemons.

APPENDIX D

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 92-1754
Summary Calendar

IN THE MATTER OF: DON RAY DIXON and DANA DENE DIXON,

Debtors.

DALE WOOTTON,

Appellant,

v.

YOUNG FAMILY TRUST,

Appellee.

Appeal from the United States District Court for the Northern District of Texas (3:92-CV-323-R)

Before KING, DAVIS and WIENER, Circuit Judges. Filed March 25, 1993.

PER CURIAM:[1]

Dale Wootton, bankruptcy trustee for the estate of Don and Dana Dixon, appeals from the district court's affirmance of the bankruptcy court's judgment in favor of the Young Family Trust. Finding no error committed by the lower courts, we affirm.

I.

In 1986, A. Peter Young, a long-time executive with Rolls Royce, Ltd., residing in California, retired. Anticipating his retirement from Rolls Royce, Young entered into employment agreements with Don Dixon and one of Dixon's companies, Symbolic Cars of La Jolla, Inc. ("Symbolic Cars"). Young's agreement with Dixon provided for Young's right to equity participation in car dealerships that were directly or indirectly owned by Dixon. Young's agreement with Symbolic Cars specifically included a stock option provision whereby

Young could purchase an eight percent interest in Symbolic Cars by purchasing eight percent of all outstanding shares. The clause provided that Young could finance the stock purchase by offering a non-recourse promissory note and security agreement in which the stock was pledged as security.

Contemporaneous with his retirement from Rolls Royce, Young exercised his stock option and tendered the required promissory note and security agreement to Dixon. In February 1987, the original option agreement was modified into an agreement whereby Young would purchase eight percent of Dixon's outstanding shares in Sterling Motor Company ("Sterling")--a subsidiary corporation of Symbolic Cars--in place of receiving stock in Symbolic[2]. Young provided a promissory note and security agreement executed in

favor of Dixon personally. Immediately thereafter, before eighty shares were delivered, Young agreed to permit Dixon to pledge Young's share of stock to a financial institution as part of Dixon's agreement to sell off part of Sterling to a third party. Ultimately, however, the pledged stock was returned to Dixon.

It is undisputed that: (I) Dixon's eighty shares of outstanding stock were never assigned to Young, (ii) no dividends on the stock were ever paid to Young, and (iii) no payments were ever made by Young to Dixon or any of his automotive companies under the terms of the promissory note that was executed by Young.

Dixon and his wife became insolvent and declared bankruptcy in 1988. Dale Wootton was appointed bankruptcy trustee. In October 1988, Wootton sold all shares of Dixon's stock in Sterling for

$1,600,000.00. On May 16, 1991, Young[3] filed a Motion for Payment of Sale Proceeds by Co-Owner, requesting his pro-rata share of the sale proceeds, or $196,222.00. Pursuant to 11 U.S.C. §157(o), the bankruptcy court conducted a hearing concerning Young's claim to the $196,222.00. The bankruptcy court rejected Wootton's contention that he could, as bankruptcy trustee, reject the stock option agreement as an "executory" contract pursuant to 11 U.S.C. §365(a). Although the court recognized that an unexercised stock option is an "executory" contract within the meaning of §365(a), see Matter of Jackson Brewing Co., 567 F.2d 618 (5th Cir. 1978), the bankruptcy court agreed with Young's claim that the stock option contract had been substantially performed under California law, which governed the stock option

contract and employment agreements. All that remained to be done at that time that the Dixons declared bankruptcy was the clerical act of reissuing the stock certificate upon transfer from Dixon to Young and payment of the promissory note by Young. Furthermore, primarily citing legislative history to the Bankruptcy Code, the bankruptcy court held that a promissory note is not an "executory" contract within the meaning of §365(a). Thus, the court ordered Wootton to pay Young $121,365.86 which represented the amount of the sales proceeds and pre-judgment interest minus the amount Young owed the estate on the promissory note.

On appeal to the District Court, Wootton again argued that he was entitled to reject the stock option agreement as an "executory" contract. Adopting essentially the same reasoning as the

bankruptcy court, the District Court affirmed Young's judgment against Wootton.

II.

On appeal to this court, Wootton again argues that the has a right to reject Young and Dixon's purchase agreement as an "executory" contract under 11 U.S.C. §365(a). In particular, Wootton argues that this court should adopt a "functional" definition of the term "executory" as used in §365(a), as opposed to the traditional "Countryman" definition.[4] Such a "functional" definition, Wootton concedes, has only been adopted by a minority of courts. See Sharon Steel Corp., v. National Fuel & Gas Distr. Corp., 872 F.2d 36, 39 (3d Cir. 1989) (noting that the "Countryman" definition has been adopted by a majority of courts). This court has never expressly adopted either definition, although we observe that the United States

Supreme Court appears to have adopted a definition akin to Countryman's. See National Labor Relations Board v. Bildisco & Bildisco, 465 U.S. 513, 522 n.6 (1984).

Wootton's argument that Young and Dixon's purchase agreement was "functionally" executory is as follows: Wootton contends that although Young technically exercised his right to purchase Dixon's stock, in effect he still had an "option" even after proffering a promissory note and security agreement. Wootton's argument is premised on the fact that the promissory note that Young executed was non-recourse and the security agreement simply provided that the stock was to be the only collateral. Wootton also points to the undisputed fact that Young planned on paying off the promissory note with dividends from the stock. Thus, Wootton argues, because Young could have

simply breached the promissory note if it appeared that dividends on the stock were not adequate to cover the amount of repayment, the arrangement was still a financial contingency similar to a stock option--whereby Young had nothing to lose but the original consideration he provided for the option. Because it was the equivalent of an unexercised stock option, Wootton concludes, it was an executory contract under the law of this circuit. *See Matter of Jackson Brewing Co., supra.*

Although we do not doubt that, in certain cases, a "functional" or "substance-over-form" definition might be appropriate[5], we believe that this case is hardly the one in which to adopt such a definition of "executory". Although in some larger sense Young still had the "option" to actually own the stock outright, free of any encumbrance, unlike

the case of a true stock option, he had--under California law--equitable title to the outstanding stock.[6] Simply because the stock certificate had not been formally issued to Young upon transfer of Dixon's certificate is of no moment under state law. See, e.g., Federal Employees Distributing Co., v. Franchise Tax Board, 260 Cal. App. 2d 937, 945 (Cal. App. 1968); Crane Valley Land Co., v. Bank of America, 182 Cal. App. 2d 166, 173 (Cal. Dist. Ct. App. 1960); Mindenberg v. Carmel Film Productions, 132 Cal. App. 2d 598, 608-09 (Cal. Dist. Ct. App. 1955). Moreover, in Young's case, unlike cases such as Crane and Mindenberg where the stock has never been formally issued, Young's stock had already been issued at the time Dixon breached the purchase agreement, albeit in a single certificate for all 650 shares of Dixon's stock in

Sterling. The issuance of a certificate for Young's eighty shares was simply a bookkeeping formality.

Thus, all that actually remained, besides this bookkeeping change, was Young's payment of the promissory note. Because a promissory note is not an "executory" contract within the meaning of §365(a), see Lubrizol Enterprises, Inc., v. Richmond Metal Finishers, Inc., 756 F.3d 1043, 1046 (4th Cir. 1985) (citing legislative history of Bankruptcy Code) we agree with Young's estate that it is entitled to the sales proceeds minus the amount Young owed on the promissory note.

III.

For the foregoing reasons, we AFFIRM the judgment of the District Court.

FOOTNOTES

1. That purchase agreement provided that, "Dixon hereby . . . agrees that 80 shares of common stock of Sterling owned by Dixon shall be assigned and transferred . . . to Young . . . Within five days of the date hereof, Dixon shall deliver an assignment of such shares to Young." Under the agreement, Dixon was required simply to direct Sterling to issue Young a new certificate for 80 shares, as Dixon's certificate was for all of Dixon's 650 shares in Sterling.

2. Young has since died. The Young Family Trust has been substituted as the appellee.

3. The namesake of the "Countryman" definition is Professor Countryman. See Countryman, *Executory Contracts in Bankruptcy:* Part I, 57 MINN. L. REV. 439, 460 (1973). 439, 460 (1973). Professor Countryman defined "executory" as meaning a bilateral agreement under which the obligations of both the bankrupt and the other contracting party remain so far unperformed that failure of either to make complete performance would constitute "material" breach excusing performance of the other.

The minority "functional" definition has been advanced primarily in academic circles. See, e.g., *Westbrook, A Functional Analysis of Executory Contracts*, 74. MINN. L. REV. 227 (1989); see also In re Drexel Burnham Lambert Group, Inc., 358 B.R. 687, 707-08 (Bankr. S.D.N.Y. 1992). Rather than announcing a

uniformly accepted "functional" definition--such as the succinct "Countryman" definition--commentators such as Westbrook simply have stated that whether a contract is "executory" should not be a talismanic precondition for court approval of rejection by a trustee. Wootton appears to argue that a "functional" definition of "executory" should consider the economic reality of a contractual situation.

4. See Bildisco, 465 U.S. at 527 ("The Bankruptcy Court is a court of equity, and in [fashioning remedies] it is in very real sense balancing the equities" of those before the court.).

5. The Bankruptcy Code expressly provides that a legal (as opposed to an equitable) interest in property possessed by a debtor at the time bankruptcy is declared remains only a legal interest possessed by the bankruptcy estate. See 11 U.S.C. §541(d).

AFFIDAVIT OF COUNSEL AS TO MAILING PETITION OF WRIT OF CERTIORARI

I, DALE WOOTTON, Counsel for Dale Wootton, Trustee, Petitioner, swear that the foregoing Petition was deposited in the United States mail with the proper postage, prepaid, on January 8, 1997.

Dale Wootton

DALE WOOTTON

STATE OF TEXAS §
§
COUNTY OF DALLAS §

SWORN TO AND SUBSCRIBED BEFORE ME, a notary public, by the said Dale Wootton, on this the 8th day of January, 1997, to certify which witness my hand seal.

Rebecca Cruise

Notary Public
The State of Texas

NOTARY PUBLIC STATE OF TEXAS
REBECCA CRUISE
Notary Public
State of Texas
My Comm. Exp. 08-12-00

My Commission Expires: 8-12-2000

Supreme Court U.S.
FILED
MAR 17 1997
CLERK

No. 96-1114

In The

Supreme Court of the United States

October Term, 1996

In the Matter of DON R. DIXON and DANA DENE DIXON,

Debtor.

DALE WOOTTON, TRUSTEE,

Petitioner,

vs.

WOODY F. LEMONS,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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18 pp

QUESTION PRESENTED

Petitioner states the question presented as follows:

> Whether or not the court should adopt the "functional" approach to defining executory contracts in bankruptcy cases, as opposed to the "countryman" approach, which appears to have been previously adopted by the court.

Petitioner misstates the issue. The question actually presented is as follows:

> Was Woody Lemons the owner of 27½% of 570 shares of Sterling Motors Ltd. stock embodied in a certificate held by Don Dixon's Bankruptcy Trustee, or was the stock "property of the bankruptcy estate"

LIST OF INTERESTED PARTIES

1. Dale Wootton, Respondent, Bankruptcy Trustee for Don R. Dixon, Chapter 7 Debtor, *pro se*

2. Woody F. Lemons, Plaintiff and Respondent

3. John D. Copeland, Counsel for Woody F. Lemons

4. Bradson Partners, Ltd., Assignee of Woody F. Lemons

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Rule Cited:

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Other Authorities Cited:

Bankruptcy Code § 365 ..... 4, 6

Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection"*, 59 U. Colo. L. Rev. 845 (1988) 6, 7

Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. Colo. L. Rev. 1 (1991) 7

Jay L. Westbrook, *A Functional Analysis of Executory Contracts*, 74 Minn. L. Rev. 227 (1989) 7

Statement of the Case

A.

Opinions Below

Appendices A, B, and C[1] to the Petition[2] are substantially correct and verbatim transcriptions of the three Lower Court Decisions.

B.

Jurisdictional Statement

Respondent has no objection to Petitioner's jurisdictional statement.

C.

Applicable Federal Question

Petitioner has misstated the issue. Respondent states the issue as follows:

> Was Woody Lemons the owner of 27½% of 570 shares of Sterling Motors Ltd. stock embodied in a

---

[1] All references to "appendix" refer to the appendices contained in the Petition.

[2] "Petition" refers to the Petition for Writ of Certiorari.

certificate held by Don Dixon's Bankruptcy Trustee, or was the stock "property of the bankruptcy estate?"

D.

Statement [of the Case] - Correction of Misstatements in the Petition

Petitioner's Statement [of the Case] is largely argument. It contains numerous factual statements that are not supported by the record or are contrary to the record. The record speaks for itself. Respondent will not burden the Court with a recitation of all Petitioner's misstatements, just a few.

Petitioner volunteers the comment, "This case arose out of the Bankruptcy case of Don Dixon, one of the principal figures in the savings and loan scandal of the 1980s." Petition at 4. The case did arise out of Don Dixon's bankruptcy, but there is nothing in the record that shows that Dixon was a principal figure in the savings and loan scandal of the 1980s. This irrelevant statement is obviously an attempt to prejudice this Court against Lemons.

Petitioner states that there is an undisputed agreement that

Lemons' interest would revert back to Dixon once Lemons was relieved of liabilities associated with the stock. Petition at 15. He argues that this is significant evidence that the arrangement in this case was an executory contract even under the "Countryman Approach" as well as under the "Functional Approach." There is not undisputed evidence that there was an agreement that the stock would revert back to Dixon once Lemons was relieved of liabilities. There was testimony to the effect that after Lemons had guaranteed $9 million in loans used to purchase the stock, and after he had become the owner of 27½% of the stock, he became convinced that owning the stock was more of a burden than a benefit. The liabilities associated with it were greater than the value of the stock. He made an offer, well after he became the owner of the stock, that if Dixon could "get him off of the notes" he would give his stock to Dixon. Dixon was never able to get Lemons off the notes, and the stock remained Lemons' property at the time Dixon filed bankruptcy. Lemons was subsequently sued as guarantor and maker of the notes used to purchase the stock. A significant judgment was taken against him. Lemons was right, the liabilities associated with the stock were

greater than the stock was worth. Lemons' victory in this case recouped him about one-fourth of his loss.

Reasons for Denying the Writ

A.

Summary of Argument

There is no compelling reason to grant the Petition. There is no conflict among the circuits, there is not a conflict on an important Federal question with a State Court of last resort, and there has been no such departure from the accepted and usual course of Judicial proceedings as to call for the Supreme Court to exercise its power of supervision. At most, Petitioner is making a case that the three lower courts that decided this issue made erroneous factual findings or applied a generally accepted rule of law (a Bankruptcy Trustee's power to reject executory contracts under Bankruptcy Code §365) incorrectly.

B.

If the Court Adopted Petitioner's Theory, It would Not Change the Result - The Decisions Below are Correct

At the time he filed bankruptcy, Dixon held a certificate for 650 shares (65%) of the stock of Sterling Motors Ltd. Peter Young, the Manager of Sterling Motors filed suit contending that he owned 80 shares of the 650 shares represented by the Certificate that was in the Trustee's hands. The Trustee countered with the argument that Young did not own the stock, but merely had an executory contract to acquire stock in the future. In the Young case the courts held that of these 650 shares, Young actually owned 80 shares, although they were embodied in the certificate for 650 shares held by the Bankruptcy Trustee. The courts rejected the Trustee's argument that Young had only an executory contract to receive stock in the future. In the Matter of Don R. Dixon and Dana Dene Dixon, Debtors. Dale Wootton, Appellant vs. Young Family Trust, Appellee, No. 92-1754, March 25, 1993. The Petitioner makes the same arguments in this case. He contends that Lemons did not own the stock but merely had an executory contract to acquire the stock in the future. All of the

lower courts rejected the executory contract theory and decided the case on a "property of the estate" theory. They held that the 27½% of the stock that Lemons claimed to own was actually his property, and it was not property of the estate.

Petitioner's Statement [of the Case] says:

> The critical issue is the determination of the nature of an oral agreement between the debtor and a business associate, and whether or not it is an executory contract, and if so, whether the Trustee can use the "functional approach" on the executory contract. Petition at 3.

Is Petitioner saying that the Functional Approach is a way of deciding whether a contract is executory or not? Or is the Petitioner saying that, if it is first determined that a contract is executory, the Functional Approach is a way for a bankruptcy trustee to determine whether to reject or accept it?

The Functional Approach appears to be Petitioner's synthesis of ideas that were discussed by two law professors in their volleying law review articles discussing problems with executory contracts under Section 365 of the Bankruptcy Code: Michael T. Andrew,

Executory Contracts in Bankruptcy: Understanding "Rejection", 59 U. Colo. L. Rev. 845 (1988); Jay L. Westbrook, A Functional Analysis of Executory Contracts, 74 Minn. L. Rev. 227 (1989); Michael T. Andrew, Executory Contracts Revisited: A Reply to Professor Westbrook, 62 U. Colo. L. Rev. 1 (1991). Petitioner tells the Court it should grant a writ because "it is now time for the courts to uniformly adopt the functional approach to analysis of executory contracts, as opposed to the formerly used Countryman definition approach." Petition for Writ of Cert. Page 11. Petitioner never states what the Functional Approach is, what it is used for, or how it would change the result from that reached under the Countryman Approach.

There is a telling admission in Petitioner's brief. His case is self-defeating. He states:

> The final reality of this case may be that it really does fit the "Countryman" definition of an executory contract, but the rationale and the logic of the "functional" approach gives even more credibility to the Trustee's position that this contract should be rejected. Petition at 17.

The Petitioner is admitting that it doesn't matter which approach is

used, the result should be the same.

If there was any executory contract in this case, it was not the arrangement whereby Lemons acquired ownership of the stock. If there was any executory contract, it was Lemons' proposal for Dixon to get him off the notes in exchange for the stock. By the time Dixon filed bankruptcy, both Dixon and Lemons were being sued for a deficiency judgment on the notes. Dixon's bankruptcy halted the deficiency suit against him. Lemons, who has never filed bankruptcy, had a deficiency judgment taken against him for approximately $1.25 million. He would have gladly given up the $300,000 recovery in this case for his stock, if the Petitioner could have relieved him of the $1.25 million deficiency judgment. If there was a binding agreement for Dixon to get Lemons off the notes, that was a second, separate, and subsequent agreement from the arrangement whereby Lemons became the owner of the stock. The second agreement may very well have been executory. If so, the Trustee has rejected it or breached it, and Lemons could have sued him for damages. The breach of that agreement would have been payable as a claim out of the bankruptcy estate in bankruptcy dollars,

and Lemons chose not to bother with it.

C.

There is No Conflict Among the Circuits

There is no conflict among the circuits regarding adoption of the Functional Approach and the Countryman Approach. Specifically, Petitioner asserts that there is a conflict between the Second Circuit in Cohen vs. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.),138 B.R. 687 (Bankr. S.D.N.Y. 1992) and the Fifth Circuit in an unpublished *per curium* opinion involving this same bankruptcy estate, where the same Petitioner lost the same issue, involving a different stockholder. In the Matter of Don R. Dixon and Dana Dene Dixon, Debtors, Dale Wootton, Appellant vs. Young Family Trust, Appellee, No. 92-1754, March 25, 1993. There is no conflict between the Cohen case and the Young case. The Cohen case reconciles nicely with the Young case. The Cohen case does not support the Petitioner's position. It supports Lemons' position. The portion of Cohen analogous to Young deals with four separate portfolios of bonds held in an escrow account. Cohen and Drexel entered into an Employment Agreement

and an Escrow Agreement (the "Agreements"). Cohen was employed as general counsel for Drexel. The terms of the Agreements provided that upon commencement of the employment Cohen was to purchase four separate valuable portfolios of bonds from Drexel for the nominal consideration of $100 each. The bonds were placed in an escrow account. The portfolios remained in escrow and were to be released, one portfolio per year, to Cohen subject only to the condition that Cohen remain employed by Drexel. One portfolio would "vest" each year. In the event Cohen was terminated for cause, any portfolios remaining in escrow were to be redelivered to Drexel. By the time Drexel filed bankruptcy, all four portfolios had "vested" although the actual bonds were still in the hands of the escrow agent. The Court found that under New York law title passed to Cohen. Id. at 710. The Court then held that because title to the bonds passed to Cohen, the trustee could not reject the Agreements with respect to the bonds and Cohen was entitled to the bond portfolios. Id. at 710-11. Cohen had fully performed. He had remained an employee and was not terminated for cause. Other than paying $100, that was all he had to do to

become the owner of the bonds.

The facts in Young are similar to those in Cohen. Young and Dixon entered into an agreement under which they would both own part of the Sterling Motors stock. Young obtained his stock by exercising a stock option agreement he received in connection with his employment. The stock was not physically transferred to Young but was held in Dixon's name. The Fifth Circuit held in Young that equitable title can pass without transfer of legal title. As in Cohen, because equitable title to the stock passed to Young, the trustee could not reject the agreement, and Young was entitled to the proceeds from the sale of his stock by the Trustee. In both Young and Cohen, the trustee was not allowed to reject the parties' property rights to securities because the parties' rights had fully vested before the filing of bankruptcy.

More fundamentally, the Cohen case is a Bankruptcy Court Opinion from the Southern District of New York, not an opinion of the Second Circuit. There is no reported Appellate decision arising from the Cohen case. The Young case is an unpublished *per curium* opinion of the Fifth Circuit. Even if the cases were in conflict (they

are not) this hardly constitutes a conflict among the circuits. Under Supreme Court Rule 10(a) this Court may grant a writ of certiorari where "a United States Court of Appeals has entered a decision in conflict with the decision of another United States Court of Appeals on the same important matter." Counsel for Respondent has not found any case in which a conflict among the circuits was predicated upon a *per curium* opinion of a Court of Appeals and a Bankruptcy Court Opinion from a different circuit. It is hard to find a conflict among the Circuits when only one Circuit has ruled. It is hard to find a conflict among the Circuits when the cases are not in conflict.

D.

There Is No Important Federal Question

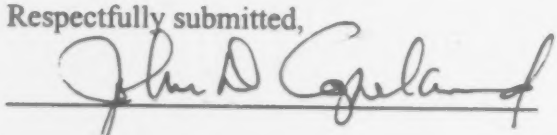
Petitioner believes that he raises an important question in the administration of Bankruptcy cases for Trustees all over the country. While there may be a fair amount of executory contract litigation in Bankruptcy cases, the courts don't seem to have excessive difficulty in dealing with executory contracts. The three lower courts that considered this case had no difficulty determining that the case did not involve an executory contract at all but simply involved a

question of whether the stock was property of the estate, and they found that it was not. Petitioner has not stated how adoption of the Functional Approach would change the result in this case, and it would not. He has not shown how it would improve the administration of justice nationwide.

Conclusion

The Petition for Writ of Certiorari should be denied.

Respectfully submitted,



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